STATE OF MAINE
PUBLIC UTILITIES COMMISSION

Docket No. 2000-542

October 11, 2000

MAINE PUBLIC SERVICE COMPANY
Application for Approval of Issue of Securities (§902) ($9,000,000) and for Approval of Mortgage (§1101) ($9,525,000)

ORDER APPROVING ISSUE OF SECURITIES AND MORTGAGE OF PROPERTY

WELCH, Chairman; NUGENT and DIAMOND, Commissioners

I. SUMMARY

On June 23, 2000, Maine Public Service Company (MPS or the Company) filed with the Commission its application for authority to execute a loan and promissory note agreement through the Maine Public Utility Financing Bank (the "Bond Bank") in a sum not to exceed $9.0 million. The Bond Bank has agreed to issue a series of tax-exempt revenue bonds in the same amount with a term not to exceed 25 years, with the proceeds of the bond sale to be loaned to the Company. The Company also seeks approval to issue First and Second Mortgage Bonds in an amount not to exceed $9.525 million in connection with this transaction. This Order approves the Company's request.

II. BACKGROUND & DECISION

This financing involves several parties and is structured to allow the Company to access funds at favorable rates for capital improvement projects to its local distribution system over the next three years. The funds will be placed in a trust account and drawn down by the Company between the years 2000 and 2003 as qualified capital improvement projects are completed. MPS expects that drafts will be made in $400,000 to $500,000 increments.

The Company has entered into a series of agreements that will allow it to place "variable rate demand notes" (VRDNs)[1] through the Bond Bank. These notes carry rates that fluctuate based on a published index at short-term tax-exempt levels and that are reset either weekly, monthly or annually. Primary benefits to the borrower include: (1) a lower borrowing rate due to the tax-exempt nature of the notes, and (2) the opportunity to secure "long-term" financing at short-term rates. The index has recently been in the 4.00% to 4.50% range and the Company estimates that "all-in" costs for the issuance should result in an initial cost of 6.50% (assuming a starting nominal rate of 4.50% and 200 basis points in upfront fees and issuance costs).

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[1] These debt instruments are also known in the investment community as "Multi-Modal Variable Rate Demand Bonds."

The VRDN issuance will possess an investment grade rating and MPS has negotiated an irrevocable, direct-pay Letter of Credit from The Bank of New York and Fleet National Bank of Maine in order to enhance the credit rating (and thus marketability) of the Bonds and to provide liquidity for the bonds. The Letter of Credit will be secured by a first mortgage in the amount of $5.0 million and a second mortgage in the amount of $4.525 million on MPS's property, and the Company will issue and deliver First and Second Mortgage Bonds in the amount of $9.525 million to the Letter of Credit providers. The additional $525,000 represents the maximum amount of interest that could accrue from a time when the bonds would be called to the time when such bonds would be redeemed, based on a rate of 10.00%.

Because this debt instrument will have a variable rate without a rate cap and therefore, there is theoretically no upper limit on the rate that MPS may ultimately pay. Ordinarily this is a prospect we would find unattractive, especially when the debt instrument in question has a relatively long maturity. However, MPS's experience with similar borrowing arrangements (VRDN's approved in Docket No. 96-241 and Docket No. 98-210) has been quite favorable to date with the average rate on the 1996 tax-exempt series issued by the Bond Bank at 3.75% and the average rate on the 1998 taxable series issued by the Finance Authority of Maine (FAME) at 5.64%. In addition, there are a number of mechanisms available to the Company to limit its exposure to upward movements in interest rates.

First, a key component of the transaction is the existence of the Letter of Credit backing the bonds. The Letter of Credit will expire on June 19, 2002, with the possibility of annual one-year extensions which the Company may request one year before any scheduled expiration date. If for any reason, the transaction is not performing as expected, the Company (or the Letter of Credit Banks) can unilaterally terminate the Letter of Credit, thus triggering redemption of the bonds at par plus accrued interest, with neither a prepayment penalty nor a call premium. Second, the Company has the option to "term-out" the VRDN, thus fixing a rate for the remaining life of the bonds at any time with no penalty.

Third, and perhaps most importantly in our view, the Company has also explored the possibility of purchasing a rate cap with a third party that would limit the nominal variable rate at between 5.50% and 6.00% for either three or five years. In terms of annual cost (in basis points), current indications are that a 3-year cap would raise MPS's annual all-in borrowing rate by 5 to 9 basis points, while a 5-year cap would add an annual cost of roughly 14 to 20 basis points. We note that if the Company had specifically requested approval of a rate cap at the cost levels indicated, we would likely have found such costs reasonable and prudent given the potential interest rate risk.

As indicated above, there are a number of ways under the proposed offering that MPS can limit its exposure to interest rate increases. As it moves forward, the Company should keep in mind our preference that it not subject itself to the risk of what are essentially unlimited increases in interest rates for any significant period of time, particularly if avoidance of that risk can be accomplished at a reasonable cost. If MPS chooses not to secure a rate cap on this debt instrument or to pursue any of the other alternatives that would limit its exposure to higher interest rates, it will face our scrutiny in any future proceeding in which embedded debt costs are at issue.

Having reviewed the application of the Company, together with data filed in support of it, it is the opinion of the Commission that the proceeds of the issuance of the bonds are required in good faith the purposes enumerated in 35-A M.R.S.A. §901. In approving this securities issue, consistent with normal practice and pursuant to section 902(4), the Commission does not imply approval of the Company's capital needs or capitalization ratio for ratemaking purposes, nor does this order limit or restrict the powers of the Commission in determining or fixing any rate.

Accordingly, we

O R D E R

1. That the Maine Public Service Company is hereby authorized to issue its securities and execute agreements in connection with borrowing a sum not to exceed $9.0 million to be used solely for the purposes described in this Order through the Maine Public Utility Financing Bank (the "Bond Bank") for a term not to exceed 25 years, for which the Bond Bank will issue a series of its tax-exempt revenue bonds.

2. That the Company is authorized pursuant to 35-A M.R.S.A. §1101 to secure its reimbursement obligation under a Letter of Credit and Reimbursement Agreement pursuant to which The Bank of New York and Fleet National Bank of Maine will issue an irrevocable, direct pay Letter of Credit in support of the bonds, by executing and delivering to U.S. Trust Bank, National Association, as First Mortgage Trustee, a Twentieth Supplemental Indenture relating to the issue of up to $5.0 million of its First Mortgage and Collateral Trust Bonds and to The Bank of New York as Second Mortgage Trustee, a Fifth Supplemental Indenture relating to the issue of up to $4.525 million of its Second Mortgage and Collateral Trust Bonds in substantially the form filed with this Commission.

3. That the Company report to this Commission, in writing, its actions under to this Order within sixty (60) days of the date of the sale of the proposed bonds.

4. That the Company report the effective interest rate on this issuance every six months beginning on December 31, 2000, until such time as the variable interest rate has either been capped or permanently fixed by the Company. This requirement would be reinstated starting on December 31 in the year of the expiration of any temporary (3-year or 5-year) rate cap.

5. That a copy of this Order be mailed to interested parties and this Docket be closed.

Dated at Augusta, Maine, this 11th day of October, 2000.

BY ORDER OF THE COMMISSION

Dennis L. Keschl
Administrative Director

COMMISSIONERS VOTING FOR:

Nugent
Diamond

NOTICE OF RIGHTS TO REVIEW OR APPEAL

5 M.R.S.A. § 9061 requires the Public Utilities Commission to give each party to an adjudicatory proceeding written notice of the party's rights to review or appeal of its decision made at the conclusion of the adjudicatory proceeding. The methods of review or appeal of PUC decisions at the conclusion of an adjudicatory proceeding are as follows:

1. Reconsideration of the Commission's Order may be requested under Section 1004 of the Commission's Rules of Practice and Procedure (65-407 C.M.R.110) within 20 days of the date of the Order by filing a petition with the Commission stating the grounds upon which reconsideration is sought.

2. Appeal of a final decision of the Commission may be taken to the Law Court by filing, within 30 days of the date of the Order, a Notice of Appeal with the Administrative Director of the Commission, pursuant to 35-A M.R.S.A. § 1320(1)-(4) and the Maine Rules of Civil Procedure, Rule 73, et seq.

3. Additional court review of constitutional issues or issues involving the justness or reasonableness of rates may be had by the filing of an appeal with the Law Court, pursuant to 35-A M.R.S.A. § 1320(5).

Note: The attachment of this Notice to a document does not indicate the Commission's view that the particular document may be subject to review or appeal. Similarly, the failure of the Commission to attach a copy of this Notice to a document does not indicate the Commission's view that the document is not subject to review or appeal.